THE HONORABLE MARSHA J. PECHMAN

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

COSTCO WHOLESALE CORPORATION, a Washington corporation, Plaintiff, v. ROGER HOEN, VERA ING, and MERRITT LONG, in their official capacities as members of the Washington State Liquor Control Board, Defendants, and WASHINGTON BEER AND WINE WHOLESALERS ASSOCIATION, a Washington non-profit corporation, Intervenor Defendant.	NO. CV04-0360P **COSTCO'S SUMMARY OF TESTIMONY IN SECOND WEEK OF TRIAL**

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SUMMARY OF TESTIMONY IN SECOND WEEK OF TRIAL

The time the testimony was given is noted where it was recorded.

Steven K. Burnell, LCB wine manager (continuation of testimony)

1. The State's actions are inconsistent with the alleged goal of reducing consumption or abusive consumption.

- The LCB has a history of reducing its mark-up on wine. As a result of a 1996 study, the LCB's reduced its mark-up on wine from 50% to 35% to reverse declining wine sales at state liquor stores. 3/27/6 at 9:10 a.m., 3/27/6 at 9:59 a.m., Exhibit 20 at 4, Exhibit 143 at 6. In October 2005, the LCB cut its mark-up on its top 100 wines from 51% to 43%. 3/27/6 at 9:58 a.m.,
- The LCB places promotional displays in its retail liquor stores to build market share. 3/27/6 at 9:13 a.m., Exhibit 143 at 36.
- The LCB promotes Washington Wine Month with special promotional activities including reduced wine prices, in-store displays and contests to increase sales. 3/27/6 at 9:17 a.m.
- The LCB introduced Washington Wine Month and works with the Washington Wine Commission to increase sales of Washington wines. 3/27/6 at 9:15 a.m., Exhibit 148.
- The LCB developed a retail services plan in 2002 that has as one of its goals to reduce the costs of goods sold and thereby lower the price. TX 175, 3/27/6 at 9:20 a.m., Exhibit 175 at 6.
- Discounts received by the LCB from suppliers are passed through to the consumer at a greater dollar amount than the original discount to the LCB. 3/27/6 at 9:32 a.m., Exhibit 330.
- Temporary price reductions on wine at state liquor stores remain in effect for three months at a time. Temporary price reductions on spirits at state liquor stores remain in effect for one month at a time. For March 2006, the LCB's list of temporary price

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reductions for spirits, wine, and beer run 24 pages. 3/27/6 at 9:41 a.m. Exhibit 5 at 3-27.

- For many years, the LCB has significantly undercut the prices of private retail stores on wine. 3/27/6 at 9:46 a.m. Exhibit 51 at 1, Exhibit 62 at 67, Exhibit 224 at 1, Exhibit 23. This has included cheap wines like Thunderbird. Exhibit 51 at 1.
- In a 2004 study, LCB's top 100 wines were compared to the private market as well as to the Nielsen average prices. The LCB, on average, priced its top 100 wines 13% lower than the private market and 89 of the 100 were below the private market. In October 2005, the LCB raised its mark-up by only 5%, from a 38% mark-up to a 43% mark-up. 3/27/6 at 9:53 a.m. Exhibit 224 at 1, Exhibit 226 at 2.
- The LCB gives case discounts of 10%, even on wine it already discounts via a temporary price reduction. 3/27/6 at 9:59 a.m.

2. In sales through its retail stores, the LCB has acted consistently with the original 1934 Liquor Act purpose of keeping wine and beer prices low to consumers.

- In a study conducted in 1975, the LCB determined that privatizing all wine sales in Washington was not good policy because it would result in consumers paying higher prices for wine. 3/27/6 at 9:47 a.m., Exhibit 51 at 1.
- Criteria used to pick wines for state liquor stores include value. The LCB does not consider temperance, overconsumption or abusive consumption when determining what wine to purchase. 3/27/6 at 10:08 a.m. Exhibit 177, Exhibit 221 at 1, Exhibit 232 at 2.
- When making temporary price reductions on wine, the LCB does not consider how the discount impacts consumption or abusive consumption. 3/27/6 at 10:10 a.m.

3. The challenged restraints are not applicable to the State.

- The LCB buys the majority of its product as bailment inventory, which means that the LCB does not pay for the product while it is stored in its distribution center and its obligation to pay for it does not begin until the product is shipped from the LCB's distribution center. Some of the product has net 30 days terms, meaning that the LCB

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has to pay for the product 30 days after it leaves its distribution center. 3/27/6 at 9:23 a.m. Exhibit 175 at 22.

- Washington distributors selling to the LCB are not bound by their posted price or the uniform pricing requirement. The LCB does not even check the posted price. 3/27/6 at 9:25 a.m.

Ken Casavant, expert witness for defendants

1. Alternatives to the restraints could equally or more effectively achieve state goals.

- Dr. Casavant did not study any other state's prices in relation to Washington beer and wine prices. 3/27/6 at 11:10 a.m.
- Dr. Casavant did not conduct any analysis on social costs, nor can he quantify the social costs. He is not an expert on abuse. 3/27/6 at 11:37 a.m., 1:39 p.m.
- Dr. Casavant did not study the ban on retailer-to-retailer sales. 3/27/6 at 11:39 a.m. He cannot explain why retailers buying from Costco would create more problems than retailers currently choosing to buy from LCB
- Dr. Casavant cannot identify any economic or social benefit as a result of the ban on central warehousing by retailers. 3/27/6 at 11:44 a.m.
- Dr. Casavant cannot identify any rationale for why a retailer would have to pay twice when picking up product from the wholesaler, as required by delivered pricing. 3/27/6 at 11:46 a.m.

2. The challenged restraints are not closely related to temperance, revenue generation or orderly marketing.

- Dr. Casavant cannot quantify how much prices are higher as a result of the restraints, 3/27/6 at 11:36 a.m., nor can he quantify how much, if any, consumption is decreased as a result of the challenged restraints. 3/27/6 at 2:01 p.m. Thus, he cannot say benefits of the restraints exceed the costs.
- He first defines "orderly" as reflecting costs of production and avoiding glut/scarcity. Later mentions avoiding problems of Prohibition era saloons, such as prostitution and other crime.

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- Mentions bootlegging as a concern in rural areas, but admits potato chips and other consumer products are not bootlegged in rural areas.

3. The restraints subsidize convenience stores and other small retailers.

   - Restraints cause significant subsidization of retailers and consumers in rural areas, as well as convenience stores in urban areas. 3/27/6 at 11:17 a.m. & 1:43 p.m.
   - Consumers shopping at large retailers are paying higher prices than they otherwise would without the restraints. 3/27/6 at 11:24 a.m.
   - Dr. Casavant did not analyze the social costs of subsidizing urban convenience stores. 3/27/6 at 1:43 p.m.

4. The challenged restraints deprive citizens of the benefits of competition.

   - Competition is restrained. 3/27/6 at 11:31 a.m.
   - A free market better allocates resources within the confines of natural restraints of a market economy. 3/27/6 at 11:48 a.m.
   - Competition is important to making the economy work effectively. 3/27/6 at 1:57 p.m. Interference with competition is considered a negative impact on the economy. 3/27/6 at 1:57 p.m.

5. The modern competitive economy assures adequate availability of wine and beer throughout the state.

   - Soda pop is available everywhere in Washington. Delivery costs associated with soda pop are no different than delivery costs for beer. The free market has not deprived rural areas of soda pop. 3/27/6 at 1:41 p.m.
   - In general, non-perishable consumer goods are not subject to price volatility. 3/27/6 at 1:46 p.m. Even perishable items like milk and eggs do not show great price volatility. The free market adequately deals with volatility/supply issues on non-alcohol products, and he has no explanation why it can't work for alcohol. 3/27/6 at 1:47 p.m.

6. The restraints result in a transfer of wealth to distributors. 3/27/6 at 1:54 p.m.

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7. Dr. Casavant knows of no other industry that imposes a prohibition on quantity discounts, a credit ban, a requirement of delivered pricing, a prohibition on central warehousing, a prohibition on retailer-to-retailer sales, a requirement to hold prices for 30 days, or a requirement to post prices for competitors which are viewable when effective. 3/27/6 at 2:00 p.m.

Frank Chaloupka, expert witness for defendants

1. General comparisons between Washington and other states do not show that the restraints have an impact on alcohol abuse. Binge drinking among young people (under 24) and teenagers is higher in Washington than California, a state that in the early 1980s repealed some of the restraints in question here. 3/28/6 at 2:42 p.m. Exhibit 315, Exhibit 341, Exhibit 184 at 5 and 6, Exhibit 230 at 5 and 6. (See Exhibits 28 and 310-312 regarding the changes in California law.)

2. The effect of prices on alcohol consumption is less than with other products: the price of alcohol is relatively inelastic.

- Price elasticity overall for alcohol is -0.52. 3/28/6 at 9:33 a.m. This means that a 10% increase in the price will produce only a 5.2% reduction in consumption. An early study concludes that beer has an elasticity of -0.3, wine -1.0 and spirits -1.5. 3/28/6 at 9:28 a.m. A more recent study concludes that the price elasticity of beer is -0.27, that of wine is -0.58, and that of spirits is -0.82. 3/28/6 at 11:17 a.m.
- Spirits have a higher price elasticity (are more responsive to price increases) than beer or wine. 3/28/6 at 11:10 a.m.
- Different populations respond to changes in price differently. Youth and young adults respond to price more than older people. 3/28/6 at 9:35 a.m.
- Beer prices are inelastic. 3/28/6 at 11:17 a.m., 1:57 p.m.

3. Evidence from past studies and from the experts' regression analyses do not show a connection between the restraints and reduced consumption.

- No published study has considered the relationship between any of the restraints and consumption, and empirical evidence of such an effect "is almost nonexistent. None of the restraints is mentioned in Dr. Chaloupka's 2002 study, before he was engaged

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as an expert in the TFWS case. 3/28/6 at 1:49 p.m. Exhibit 336 at 24 (third page), Exhibit 337 at 547 (seventh page).

- Necessary data has not been collected to do a proper study of any connection between the restraints and consumption or abuse.
- Dr. Chaloupka's regression models for beer consumption in Delaware showed no effect on consumption, and his models for Nebraska were irrelevant because Nebraska did not have any restraints at any time on beer. 3/28/6 at 1:53 p.m.
- Dr. Chaloupka's regression models for wine consumption in Nebraska showed no effect. In fact, they showed that actual wine consumption in Nebraska was lower than the level projected in Dr. Chaloupka's regressions. Dr. Chaloupka admits the result was unexpected. 3/28/6 at 10:25 a.m. Exhibit 579 at 11.
- Dr Chaloupka's regression models for Delaware wine present a red flag, because they show that excise taxes had a positive coefficient, meaning that as the tax rose consumption also rose. 3/28/6 at 2:25 p.m. Exhibit 578 at 11
- Dr. Chaloupka's Nebraska regression model for spirits present another red flag, because they predict consumption more than four times lower than that in a control state, Washington, and more than two times lower than that in one of the lowest consuming states, Utah. 3/28/6 at 2:10 p.m. Exhibit 338, Exhibit 333, Exhibit 579 at 7.
- Dr. Chaloupka's regression model for overall consumption in Nebraska shows that actual overall consumption is higher than what the models projected, but by more than 20%. Since the price elasticity for all alcohol is –0.52, it would have required a 40% price decrease to achieve that result. This suggests an error in the model. 3/28/6 at 2:15. Exhibit 579 at 3.
- Dr Chaloupka's Delaware regression models do not account for the fact that Delaware is a small state that borders Pennsylvania (a monopoly state), and that the consumption data for Delaware measures sales in Delaware of product purchased by Pennsylvanians and consumed in Pennsylvania. New wine superstores in Delaware

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in the early 1990s advertised aggressively in Pennsylvania, which potentially affected the regression results. 3/28/6 at 2:25 p.m.

- Dr. Chaloupka made no effort to tie the change in Delaware or Nebraska policies to health/abuse outcomes (as opposed to just consumption).
- Dr. Chaloupka looked at one Nebraska Supreme Court decision that eliminated price posting and a quantity discount ban for wine and distilled spirits, but that decision expressly found that the restraints were not effective in limiting consumption. Dr. Chaloupka did not look at other Nebraska decisions that potentially impacted the number of alcohol outlets in Nebraska. 3/28/6 at 2:22 p.m.
- Dr. Chaloupka's Regression models may have an omitted variable bias. 3/28/6 at 2:37 p.m.

4. The "full price" of beer and wine under the restraints is lower than the monetary price.

- Consumption is affected by the "full price" of alcohol, which takes into account not just the monetary price, but also the costs to the consumer in time and convenience in making a purchase, the informational cost in learning about a product (such as via in-store promotions), and the perceived health and legal consequences of a purchase. 3/28/6 at 11:20 a.m.
- Dr Chaloupka's published studies focus on the full price of alcohol, not simply the monetary price. 3/28/6 at 1:42 p.m., Exhibit 336

5. The first "P" of the four "Ps" of marketing – Product, Promotion, Placement, and Price – can increase consumption. 3/28/6 at 11:20 a.m.

- Flavored malt beverages, also known as "alcopops," are marketed to and spur consumption by teenage girls. Dr. Chaloupka is aware that other states are seeking to place a higher tax on alcopops and that the LCB has allowed them to be sold as beer by the private sector in Washington. 3/28/6 at 11:24 a.m.
- There are concerns that availability of strong beer spurs overconsumption in some communities. 3/28/6 at 11:27 a.m.

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- Efforts to make strong beer more available would lead to higher alcohol consumption. Dr. Chaloupka is aware that Washington in 2003 allowed stronger beer to be sold by the private sector. 3/28/6 at 11:27 a.m.
- The greater variety of products, the more likelihood of increased consumption. 3/28/6 at 11:27 a.m.

6. The second “P,” increased promotional activity, increases consumption.

- Advertising increases alcohol consumption. Liberalizing advertising restrictions would spur consumption. 3/28/6 at 11:29 a.m.
- Happy hours spur consumption. 3/28/6 at 11:49 a.m. Exhibit 4 sets out examples of happy hours promotions in the Seattle area that spur consumption. A number of other states prohibit happy hour promotions. 3/28/6 at 11:50 a.m. Exhibit 31.
- "Point of purchase (POP) (i.e., on-site) marketing, including alcohol advertising and placement, can increase alcohol sales and consumption substantially." 3/28/6 at 11:30 a.m. Exhibit 181.
- Small convenience stores and gas station stores have more point-of-purchase promotion of alcohol than do supermarkets, including more ”Exterior alcohol advertisements,” more “high-intensity exterior alcohol advertising," more "Interior alcohol advertising” and more "Low height advertisements” that will catch attention of children. 3/28/6 at 11:33 a.m. Exhibit 181.
- "POP alcohol marketing is extensive in stores frequented by US teenagers and young adults.” ”[C]onvenience stores and small grocery stores had the most accessible alcohol products…." "POP marketing can increase total beer sales by as much as 17% and influences consumer purchase behavior, with 70% of a buyer's purchasing choice occurring after the buyer enters the retail establishment." "Persons aged 21-27 years are more likely to purchase beer in convenience stores and liquor stores than in supermarkets and drug stores, and 75% of teenagers shop at convenience or convenience/gas stores weekly." 3/28/6 at 11:36 a.m., Exhibit 181, Exhibit 335.

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- In store promotions increase alcohol consumption. A state policy that provides incentives to engage in more alcohol promotion would have the effect of stimulating consumption. 3/28/6 at 11:37 a.m.

7. The third "P," placement of alcohol inside a retail store and greater availability of alcohol, increase consumption.

- Placement of product spurs consumption because it allows for ease of access (self service vs. clerk-assisted), readiness to be consumed (cooled vs. room temperature), and affordability (availability of singles). 3/28/6, Exhibit 335.
- Availability of "minis" or any other single serving of alcohol in retail stores increases consumption. 3/28/6 at 11:43 a.m.
- Type of placement – such as placement on shelves, singles in a bucket, or in a refrigerator/cooler – also contributes to increased sales of beer. 3/28/6 at 11:44 a.m.
- An increase in the number of outlets and other increases in availability increase beer and wine consumption. 3/28/6 at 11:45 a.m.
- A state policy that provides incentives to make alcohol more available would have the effect of stimulating consumption. 3/28/6 at 11:45 a.m.

8. There is no evidence showing to what extent monetary price alone has an effect on consumption.

- Dr. Chaloupka did not analyze what impact an increase in the wholesale price has on the ultimate retail price. 3/28/6 at 11:47 a.m.
- Dr. Chaloupka has not analyzed whether monetary price has to be high and relatively constant to impact consumption. 3/28/6 at 11:48 a.m.
- Volatile *retail* prices have less impact on consumption than long-term price changes. 3/28/6 at 11:48 a.m.
- One third of all ethanol sales in the State of Washington are made by the LCB. 3/28/6 at 11:08 a.m.

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- Dr. Chaloupka was unaware that WAC 314-52-114 allows below cost sales of beer and wine in a good faith endeavor to meet competition, such as by meeting the price of a retailer that has obtained cheaper wine from an LCB store. 3/28/6 at 11:53.
- Studies on the effect of prices on alcohol referred to in Dr. Chaloupka's published articles post-date the challenged restraints. Exhibit 336, Exhibit 337.

10. The restraints do not have the same effect as taxes.
    - Hypothetically, in a state where beer taxes are routinely defeated, inflation will lower the impact of beer taxes resulting in increased consumption, all else being equal. 3/28/6 at 11:59 a.m.
    - "Since the price of alcohol can be manipulated through excise tax policies, the findings regarding the relationship between alcohol price and alcohol consumption clearly are relevant for policymakers interested in reducing alcohol consumption and it adverse consequences." 3/28/6 at 1:31 p.m., Exhibit 336 (third page).
    - In contrast with tobacco taxes, taxes on alcohol have not been directly used as a tool to control consumption.

11. Non-price alternatives to the restraints are effective.
    - "The major policy element of U.S. programs to deter teenage and young adult drinking has been to increase State minimum legal drinking ages (MLDAs)." 3/28/6 at 1:32 p.m., Exhibit 336 (third page).
    - "In addition, several States have recently adopted laws targeting underage drinking drivers by making it *per se* illegal to drive either with blood alcohol concentration (BACs) well below those considered the legal limit of intoxication in adults (i.e., 0.08 to 0.1 percent) or, in some States, with any measurable BACs." 3/28/6 at 1:34 p.m., Exhibit 336 (third page).
    - "Many States and localities also have adopted policies that raise the time costs associated with obtaining alcoholic beverages or otherwise reduce alcohol availability for all drinkers. For example, these policies include regulations that limit the places and/or times where alcohol can be sold, restrict or ban "happy hours," require server

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training and/or licensing, and hold servers liable for the harmful actions related to the excessive drinking of those they are serving. 3/28/6 at 1:37 p.m., Exhibit 336 (third page).

- Monies from taxes could be used to increase DUI enforcement and the number of LCB enforcement agents that conduct sting operations. 3/28/6 at 3:18 p.m.
- Monies from taxes can be used for counter-advertising. Counter-advertising can be an effective tool for controlling alcohol abuse. 3286 at 3:19 p.m.

13. The restraints result in a transfer of wealth to distributors.

- Majority of surplus created by higher prices ends up with distributors. 3/28/6 at 1:50 p.m.
- Dr. Chaloupka did not analyze what wholesalers do with the surplus they receive as a result of higher prices resulting from the restraints. 3/28/6 at 1:50 p.m.

Keith Leffler, expert witness for plaintiff

1. The restraints, as a whole and each separately, harm the economy because they are anticompetitive and produce inefficiencies in marketing and sale of beer and wine. There are no procompetitive effects. 3/29/6 at 9:06 a.m.

- Price posting makes known to wholesale competitors information that would otherwise not be available to them. It thus makes their prices transparent and makes tacit collusion (cooperation among sellers that is not otherwise unlawful) more likely, promoting higher prices. 3/29/6 at 9:11 a.m.
- The thirty-day hold makes the transparency of prices even more damaging because the transparent price is in effect for a set amount of time. 3/29/6 at 9:12 a.m.
- The thirty-day hold requirement is inefficient because it prevents wholesalers and distributors from reacting to changes of supply and demand. It thus has the effect of increasing the likelihood of gluts and shortages (rather than preventing them, as Casavant suggested). 3/29/6 at 9:12 a.m.
- Minimum mark-up requirement is inefficient because it interferes with the ability of distributors to price to manage inventory efficiently, such as to qualify for volume

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rebates from producers or to deal with "dating" (product freshness) issues. 3/29/6 at 9:15 a.m.

- Uniform pricing requirement aggravates the anticompetitive effects created by increased price transparency. Independently, it causes economic inefficiencies by disrupting the business models of retailers. Some retailers, like Costco, are required to pay for services they do not need, or they consume services they would not otherwise utilize because there is no marginal cost to utilizing those services (for which extra would be charged in a competitive economy). True costs are not reflected in uniform pricing. 3/29/6 at 9:17 a.m.
- The restrictions stifle the incentive to innovate. Potentially efficient retailers have no reason to attempt to increase efficiencies (such as by undertaking services that are currently required to be performed by distributors) because they will pay same price as the inefficient retailer. Higher cost retailers like convenience stores face no pressure to reduce costs and innovate. 3/29/6 at 9:19 a.m.
- Uniform pricing also reduces a distributor's incentive to be efficient. 3/29/6 at 9:19 a.m.
- The ban on volume discounts is an example of inefficiency because it takes away the incentive to be efficient (such as buying inventory in truckloads). 3/29/6 at 9:20 a.m.
- Delivered pricing is an example of inefficiency because it takes away the incentive to be efficient and because true costs are not reflected in the ultimate price paid. 3/29/6 at 9:20 a.m.
- The ban on credit sales is generally inefficient. It can result in drivers handling billing and carrying checks around as part of their distribution duties. 3/29/6 at 9:23 a.m.
- The ban on credit sales injures the smaller retailer more than large retailers. Small retailers do not have the ability to use the credit line of their distributor to carry the product, while larger retailers generally have better credit lines than they would by using the distributor's credit. 3/29/6 at 9:24 a.m.

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- The ban on central warehousing limits efficiencies of economy, specifically for retailers that have their own distribution system such as Safeway. Such retailers have a business model that is constrained by the central warehousing ban because the ban requires all retailers to receive beer and wine in the same manner. 3/29/6 at 9:27 a.m.
- In a free market, the mechanics of price lead to efficient decision-making by the purchaser. A purchaser making decisions with the current restraints in place cannot make an efficient decision because the price does not reflect the real cost of obtaining the goods.
- The retailer-to-retailer ban is a classic anticompetitive restraint that prevents retailers with business models similar to Costco from competing with distributors and from taking advantage of the efficiencies they have created in their business model. The current system illustrates the competition that can result from retailer to retailer sales – on-premises retailers have the choice of buying from distributors or from State stores (which can offer lower prices because they are not subject to the restraints). In Juneau, Alaska, for example, Costco is able to sell to other retailers, and 40% of beer and wine sales take this form, providing significant competition to local distributors. 3/29/6 at 9:35 a.m.
- Requiring uniform pricing results in economic price discrimination because it interferes with the price mechanism in that it cannot reflect the cost of doing business (example of charging men and women the same amounts for life insurance). 3/29/6 at 9:49 a.m.
- On average, the restraints increase the prices paid by Costco for beer and wine in Washington about 4.5% versus what Costco pays in California, where there are far fewer restraints. Costco pays lower prices in California even for Washington wines.
- Not all of the restraints have the impact of increasing prices. 3/29/6 at 9:36 a.m. The hold requirement could occasionally result in prices being maintained at a lower level they otherwise would.

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- Analyzing effects on consumption caused by changes in “average price” is not meaningful because no one pays an "average price." 3/29/6 at 9:38 a.m. The effect of the restraints here is mixed – customers of “favored” retailers pay lower prices, while customers of “disfavored” retailers pay higher prices.

2. Restraints tilt the playing field in favor of small retailers and thus increase consumption and abusive consumption.

- In addition to the pricing subsidy, the ban on central warehousing favors convenience stores, small taverns, and gas station mini-marts. 3/29/6 at 9:27 a.m.
- The restraints create an incentive for the existence of additional convenience stores because they do not pay the true cost of their supply. The existence of more convenience stores results in increased availability of alcohol and leads to an increase in consumption. 3/29/6 at 9:40 a.m.
- The restraints affect customers who purchase from favored retailers more than those who purchase from disfavored retailers because those shoppers will get better prices than they otherwise would without the restraints. Underage drinkers shop more at convenience stores and gas station/mini-marts than they do at "disfavored" retailers. 3/29/6 at 9:55 a.m.
- The restraints encourage the marginal retailer to enter and to remain on the edge. 3/29 at 9:58 a.m.

3. The restraints stimulate non-price competition.

- The restraints limit price competition among distributors, increasing the margins of distributors. 3/29/6 at 9:41 a.m.
- Distributors have incentives to use the increased revenue from the restraints to promote products more than they would without the restraints. 3/29/6 at 10:33 a.m.

4. The restraints do not promote an orderly market.

- Economists generally do not recognize the phrase “orderly markets.” The restraints do not promote an orderly market even as that term is defined by Dr. Casavant. 3/29/6 at 10:00 a.m.

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- Prices under the current restraint system do not reflect cost, and gluts and shortages are not controlled by the restraints. Thus, the restraints promote disorder. 3/29/6 at 10:00 a.m.
- The restraints do not prevent true price discrimination; they promote it.
- The defendants' claim of leveling the playing field is wrong. The restraints are comparable to major league baseball requiring all batters to hit right-handed. Economically, a level playing field is one in which each competitor is able to take advantage of its own attributes and efficiencies.

5. The restraints are not necessary to enforce other non-challenged restraints.
    - The challenged restraints are not necessary to enforce the prohibition on sales below cost. 3/29/6 at 10:30 a.m.
    - The challenged restraints are not necessary to enforce general prohibitions against anticompetitive price discrimination. 3/29/6 at 10:30 a.m.

6. Increasing price through a sales tax does not interfere with economies of scale as the challenged restraints do. Taxes do not favor certain buyers nor alter promotional decisions because the money goes to the state, not distributors. 3/29/6 at 10:19 a.m.

7. If one wanted to determine whether any effects on abusive consumption caused by the restraints outweighs the harms to competition and efficiency, one would gather and compare information on the costs and benefits. Dr. Leffler has seen no evidence that he believes shows any benefits from the restraints. Nor is there any evidence that the Legislature or the LCB engaged in such a balancing analysis.

Philip Wayt, Executive Director of Washington Beer and Wine Wholesalers Association

1. Wholesalers are able to use the surplus they receive from the restraints to oppose measures that may reduce consumption or abuse.
    - WBWWA opposed the Washington State Medical Association's petition to restrict advertising targeted at underage drinking, and proposals to restrict alcohol logos on toys and children's clothing. 3/29/6 at 11:04 a.m. Exhibit 89, Exhibit 92

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- WBWWA opposed the Washington State Medical Association's proposal to reduce the minimum alcohol level for drunk drinking from 0.1% to 0.04%. and has consistently opposed reductions in the Blood Alcohol Content (BAC) measure. TX 88, 3/29/6 at 11: 12 a.m., Exhibit 88.
- WBWWA is afraid lowering the BAC will impact beer sales because people will be "afraid to stop and have a beer." 3/29/6 at 11:26 a.m.
- WBWWA obtained a change in the law to require retailers to give sales data to wholesalers for free. Wholesalers use the data to develop store schematics that help promote alcohol sales. Previously, retailers had sold the data to wholesalers. 3/29/6 at 11:34 a.m.
- WBWWA was successful in defeating a budget request for Washington's Department of Health to fund a TV counter-advertising campaign aimed at underage drinkers. 3/29/6 at 11:23 a.m., Exhibit 129.
- WBWWA opposed a proposed 1999 City of Seattle advertising ban. 3/29/6 at 11:25 a.m., Exhibit 161.
- WBWWA was successful in rolling back previously legislated beer tax in 1997. Beer taxes have not increased since 1997. WBWWA has regularly opposed beer taxes. 3/29/6 at 2:08 p.m.
- WBWWA led efforts to defeat a beer tax increase. "Briefly, it was a great session for wholesalers in Washington. In addition to defeating a huge beer tax increase, the legislature 1) passed a strong beer sales bill for grocer stores which we supported, …" 3/29/6 at 2:09 p.m., Exhibit 183
- WBWWA opposes tax equalization which would level the tax on beer, wine and spirits. Tax equalization could raise the beer tax which would have adverse effect on WBWWA's members' beer sales. 3/29/6 at 2:12 p.m.

2. The 1995 legislation that put many of the restraints into a statute did not involve the Legislature's consideration of temperance or other purported Twenty-First Amendment purposes.

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- In January 1995, the LCB presented members of WBWWA at their Winter Board of Directors and General Membership meeting with the possibility that price posting could be eliminated. 3/29/6 at 11:39 a.m., Exhibit 118.
- In March 1995, as a result of a threatened lawsuit regarding the price posting regulations, the LCB told WBWWA that it thought that putting the price posting regulation into statute would make it more defensible. WBWWA decided to support the idea and had a follow-up meeting with the LCB. LCB and WBWWA traded proposed language for an amendment to an existing bill. 3/29/6 at 11:49 a.m., Exhibit 125, Exhibit 126, Exhibit 128.
- WBWWA's lobbyist joined the LCB in testifying before the Senate Labor, Commerce and Trade Committee on the proposed amendment. The testimony made no mention of temperance or other purported Twenty-First Amendment purpose. 3/29/6 at 11:52 a.m., Exhibit 127, Exhibit 309,
- WBWWA drafted the "Intent" section of the amendment, which became RCW 6.28.180(1). 3/29/6 at 12:00 p.m., Exhibit 133, Exhibit 134.

3. The restraints do not serve any purpose to promote temperance, revenue generation, or orderly marketing.

- WBWWA worked out limits on shipments that could occur from a bonded warehouse in a deal with the Washington Wine Institute that the LCB rubber-stamped. The agreed language limited a winery to shipping no more than 2000 cases of wine from a bonded warehouse in a year to all retailers in the aggregate. The rule derived from a 1984 statute that first imposed the central warehousing ban. TX 130, 3/29/6 at 1:46, Exhibits 130, 138, 140, 144.
- WBWWA sought and received Internet access to the LCB's computerized price posting system "to view the price postings of their competitors." 3/29/6 at 1:50 p.m., Exhibit 158
- In 1988, the LCB maintained a position of neutrality on the issue of credit bans. WBWWA successfully opposed a proposal to abolish the credit ban despite support

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by beer manufacturers, grocery chains and the Washington Food Dealers Association. 3/29/6 at 2:01 p.m., Exhibit 82, Exhibit 84.

- Strong beer was at one time sold exclusively at LCB retail stores. In 2003 WBWWA successful supported moving strong beer sales from state liquor stores to the private sector. 3/29/6 at 2:10 p.m.

Michael Moore, expert witness for plaintiff

1. Summary of opinions: The defendants have not shown that the challenged restraints affect alcohol abuse in Washington: (a) the charts comparing abuse figures in Washington versus other states lack statistical controls necessary to explain the reasons for the variations; (b) the regression analyses for Nebraska and Delaware are not informative; (c) the literature relating to the relationship between price increases (primarily through taxes) and abuse consequences does not apply in analyzing the challenged regulations because the price effects of the restraints have offsetting effects (due to "cross subsidization" effects and effects on non-price competition caused by the wealth transfer to distributors). In addition, the effectiveness of efforts targeted specifically at abuse would be greater because they would not have the offsetting effects created by the challenged regulations. Similarly, affecting consumption by increasing the cost to consumers through taxes would not create these offsetting effects.

2. The restraints subsidize convenience stores and other high-cost retailers.

    - Uniform pricing results in cross-subsidization, with large-volume and efficient retailers subsidizing convenience stores and other small retailers.
    - Subsidization of convenience stores has the effect of making such stores more profitable than they otherwise would be without the restraints, increasing the number of such stores, outlet density, the amount of shelf space given to beer and wine, and in-store promotional activity (such as signs and coolers) for beer and wine. 3/29/6 at 2:35 p.m.
    - This cross-subsidization reduces the "full price" of beer and wine by increasing the convenience and reducing search costs. 3/29/6 at 2:37 p.m.

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- This offsetting "subsidy" effect of the restraints has an impact on abusive consumption because increasing the density of outlets increases abusive outcomes and because the majority of underage drinkers purchase beer and wine from convenience stores. 3/29/6 at 2:38 p.m.

3. The restraints stimulate non-price competition.

- There is a wide range of non-price competition created by the challenged restraints, including increased promotional activity, increased services provided to retailers by distributors, increased point-of-purchase advertising, and increased beer and wine signage. 3/29/6 at 2:40 p.m.
- Targeted policies (such as minimum drinking ages, DUI laws, education, banning "alcopops" and "happy hours") are more effective in that (1) they are directed toward abuse, and (2) they do not have negative consequences for consumers who are moderate drinkers (as the majority is). The challenged restraints are a "blunt instrument" because of their affects on moderate drinkers.

4. There is no evidence that elimination of the restraints would affect alcohol consumption.

- Dr. Chaloupka's Nebraska regressions suggest that something else besides the deregulation policy was affecting beer consumption. Beer regulations were not changed, so beer consumption would have been expected to go the opposite direction from what actually occurred.
- The Nebraska wine models predicted results that were the opposite of what actually occurred. If relaxation of restraints decreases price, consumption should have gone up.
- The Nebraska spirits regression of Dr. Chaloupka performed as expected; however, the model projections were abnormally low, suggesting a missed specification in his models.
- It would have been possible to construct models seeking to demonstrate the effect on measures of abuse (rather than just consumption), but Dr. Chaloupka did not attempt to do so.

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- The Delaware regression models have limitations because they had no control group or baseline upon which to make comparisons and account for background effects.
- The Delaware regression models were flawed also because there are anomalies with smaller states and resulting cross-border purchases, such as from Trenton and Philadelphia.
- Thus, the Delaware models do not show that deregulation there caused increased consumption.
- California regression models show that the elimination of alcohol restraints on wine and spirits in California had no effect on consumption. The beverage-specific California regression models used beer as a control group. Wine and beer performed the same when California's wine restraints were eliminated in 1980, and actual California wine consumption was less than predicted. Beer and spirits performed the same when California's spirits restraints were eliminated in 1982. The conclusion is that the elimination of the regulations had no impact on consumption. 3/29/6 at 3:23 p.m., 3:51 p.m., Exhibits 317, 314, 331,

5. There is no evidence that the challenged restraints affect alcohol abuse.
   - Washington has a higher percentage of alcohol related fatality accidents relative to all fatal accidents as compared to California, and Washington's rate is also 4% higher than the national average. 3/29/6 at 3:35 p.m., Exhibit 27.
   - Dr. Moore's methodology concerning this measure is superior to Dr. Chaloupka's; utilizing the comparison based on percentage of total fatal accidents (versus total miles traveled) because it controls for other factors in the state that might contribute to fatal accidents.
   - The evidence does not show that the challenged regulations have any effect on alcohol abuse in the State of Washington. 3/29/6 at 2:26 p.m., 3:38 p.m.

DATED: April 1, 2006.

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DECLARATION OF SERVICE

I declare that on April 3, 2006, I caused to be served upon counsel of record, listed below, via efiling, a true and correct copy of the foregoing Costco's Summary of Testimony in Second Week of Trial to the following:

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED: April 3, 2006 at Seattle, Washington.

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